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GENEVA FOR USMTN, PARIS FOR USOECD, BRUSSELS FOR USEC

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SUBJECT: COOPER-MATSUKAWA MEETING, 5 APR 78

1. SUMMARY. UNDER SECRETARY COOPER MET FINANCE VICE MIN-
ISTER MATSUKAWA ON APR 5. MATSUKAWA EXPLAINED THE POLITICAL
AND ECONOMIC DIFFICULTIES CAUSED BY RAPID YEN APPRECIATION.
HE EXPLAINED ALL THAT JAPAN WAS DOING TO STEM FURTHER APPRE-
CIATION AND SAID LACK OF SUCCESS WAS CAUSING A CREDIBILITY
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GAP BETWEEN BUSINESS AND THE LDP AND POLITICAL UNREST AMONG
LDP LEADERS. HE ASKED THAT THE USG DO WHAT IT COULD TO KEEP
THE YEN-DOLLAR RATE STABLE BY WORKING ON ENERGY, ANTI-
INFLATION AND EXPORT POLICIES. HE ENDED HIS PRESENTATION
BY ASKING INDIRECTLY IF THE USG WOULD INTERVENE IN EXCHANGE
MARKETS TO SUPPORT THE DOLLAR VIS-A-VIS THE YEN. MR. COOPER
REPLIED THAT THE PRESIDENT WILL ANNOUNCE ANTI-INFLATION AND
EXPORT POLICIES SOON. ADMINISTRATIVE ACTION IN THE ENERGY
IS POSSIBLE, BUT AN ENERGY BILL WOULD BE MUCH BETTER. IM-
PROVING THE LONG TERM FUNDAMENTALS WILL GIVE A FAVORABLE

PSYCHOLOGICAL SHORT TERM IMPACT TO THE MARKET. JAPAN COULD TAKE SIMILAR ACTION. COOPER URGED MATSUKAWA TO HAVE FINANCE SUPPORT MITI IN GETTING SOME SUCCESS STORIES FROM THE TRADE FACILITATION COMMITTEE/TRADE STUDY GROUP -- THIS WOULD HELP MAKE US FIRMS "EXPORT-MINDED." HE ALSO URGED MATSUKAWA TO HAVE GOJ PRESENT A GENEROUS MTN OFFER, LEST WE AND THE EC

BE FORCED TO WITHDRAW PART OF OURS. COOPER TOLD MATSUKAWA GERMANS HAD CUT TARIFFS IN HALF IN 1957 WITHOUT ASKING FOR CREDIT IN ORDER TO "CATCH UP" TO LOWER LEVELS OF TRADING PARTNERS -- AND JAPAN SHOULD DO SAME WITH CUTS OF THE EARLY 1970S. END SUMMARY.

2. AFTER BRIEF COURTESIES, MATSUKAWA MADE HIS PRESENTATION. THE JAPANESE ECONOMY WAS ON AN UPWARD TREND IN FEBRUARY. INVESTMENT AND CONSUMPTION WERE MOVING WELL. BUT SINCE MID-MARCH, FOREIGN EXCHANGE MARKETS HAVE BEEN TURBULENT, THAT IS, SINCE THE MAR 13 TREASURY-BUNDESBANK ANNOUNCEMENT. THERE HAS BEEN EXTREMELY RAPID YEN APPRECIATION, DESPITE BANK OF JAPAN INTERVENTION. THE YEN HAS APPRECIATED EIGHT PERCENT VIS-A-VIS THE DOLLAR IN THE LAST TWO WEEKS.

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3. YEN APPRECIATION HAS CAUSED CONCERN AMONG BUSINESS GROUPS AND HAS CREATED A CREDIBILITY GAP BETWEEN THE GOJ AND BUSINESS, MATSUKAWA SAID. THERE IS POLITICAL UNREST. EVEN AMONG THE LIBERAL DEMOCRATIC PARTY LEADERS, YEN APPRECIATION HAS CAUSED UNREST.

4. MATSUKAWA SAID THE GOJ WAS TRYING HARD TO COOPERATE ON ECONOMIC ISSUES. THE LARGE GOJ BUDGET, A LOW DISCOUNT RATE; THE MAR 25 ECONOMIC CABINET 7-POINT PLAN ALL SIGNED GOJ COOPERATION. THE GOJ KNEW FULL WELL THAT THE LARGE JAPANESE SURPLUS WAS THE FUNDAMENTAL CAUSE OF YEN APPRECIATION. BUT US POLICY ALSO PLAYED A ROLE.

5. MATSUKAWA SAID "SOME SAY" USG OFFICIALS DO NOT UNDERSTAND AND DO NOT WANT TO UNDERSTAND JAPAN'S PROBLEMS. THE CABINET MINISTERS DECIDED THAT ONE OF THEM SHOULD GO AND EXPLAIN, "BUT NO ONE VOLUNTEERED." SOME THEN SAID PROBLEM REFLECTED A LACK OF SUCCESS IN MATSUKAWA'S EFFORTS WITH USG. THUS, PRIME MINISTER FUKUDA SENT MATSUKAWA TO WASHINGTON TO EXPLAIN. IN JAPAN, ECONOMIC PROBLEMS, UNEMPLOYMENT PROBLEMS ARE CAUSING UNREST, PARTICULARLY AMONG THE YOUTH -- FOR EXAMPLE, SOME ASCRIBE THE RAMPAGE AT NARITA TO THIS SOURCE.

6. MATSUKAWA SAID THE GOJ MUST ASK FOR USG EFFORTS. THE USUAL USG RESPONSE IS THAT THE LACK OF AN ENERGY BILL AND HIGHER GROWTH IN THE US THAN ABROAD MUST BE ADDRESSED FIRST

BUT THIS SUGGESTS THAT THE USG DOES NOT DO ADMINISTRATIVELY WHAT IS POSSIBLE WITHOUT RELYING ON CONGRESS, FOR EXAMPLE, MOVING AGAINST INFLATION, DEVELOPING EXPORT-MINDED ATTITUDES IN FIRMS, WORKING ON ENERGY-SAVING TECHNOLOGY. IN CONTRAST; MATSUKAWA SAID MANY JAPANESE FIRMS ARE NOW IMPORTED-MINDED,

E.G., SONY. HE ASKED WHY COULD NOT THE USG PERSUADE FIRMS TO BE EXPORT-MINDED AND TO USE LESS ENERGY.

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7. THEN, MATSUKAWA REACHED THE CODA. HE SAID SOME CABINET MINISTERS BELIEVE LACK OF USG ACTION SUGGESTS TO MARKET THAT USG HAS NO PLANS TO DEFEND THE DOLLAR AND SOME BELIEVE USG POLICY IS MALIGN NEGLECT. SOME CABINET MINISTERS WANT TO ASK THE USG TO INTERVENE, AND ONE MINISTER (I.E., MIYA-ZAWA) HAS SUGGESTED THAT THERE SHOULD BE SOME SORT OF PEGGING PLAN. HE CLOSED BY SAYING THAT THE MORE INVOLVED THE CABINET MINISTERS BECAME, THE MORE THEY CRITICIZED.

8. MR. COOPER REPLIED THAT HE WAS GLAD MATSUKAWA HAD COME TO WASHINGTON AND REALIZED HOW TROUBLESOME YEN APPRECIATION MUST BE. MATSUKAWA HAD PRESENTED A FAIR CASE. SENIOR USG ECONOMIC POLICY OFFICIALS HAD PUT A CASE ON THE NEED FOR ENERGY AND ANTI-INFLATION POLICIES TO THE PRESIDENT, WHO AGREED IN PRINCIPLE. THERE SHOULD BE SOME NEW POLICY DEVELOPMENTS THE WEEK OF APR 10. OF COURSE, THE ANNOUNCEMENT OF NEW POLICIES WOULD NOT TURN AROUND FOREIGN EXCHANGE MARKETS.

9. MATSUKAWA INTERJECTED THE FERVENT HOPE THAT THE POLICY ANNOUNCEMENT(S) WOULD EMPHASIZE THE INTERNATIONAL EFFECT AS WELL AS THE DOMESTIC EFFECT.

10. COOPER SAID THAT SOME ADMINISTRATIVE ACTION ON ENERGY IS POSSIBLE. TO TAKE IT NOW WOULD JEOPARDIZE THE ENTIRE ENERGY BILL. THE PRESIDENT WILL TAKE THE ACTION IF NECESSARY, BUT IT WOULD BE MUCH BETTER TO HAVE AN ENERGY BILL. WE REALIZE THE INTERNATIONAL ASPECTS OF OUR ENERGY POLICY. WE ALSO KNOW THAT THE EFFECTS OF THE ENERGY BILL WILL NOT BE FELT FOR SEVERAL YEARS.

11. COOPER SAID THAT USG IS WORKING ON A NATIONAL EXPORT POLICY. WE EXPECT A BROAD POLICY STATEMENT ON INFLATION, CONFIDENTIAL

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WHICH MAY ALSO COVER EXPORTS, AS WELL AS INFLATION.

12. RESPONDING TO THE JAPANESE CHESTNUT THAT US FIRMS DO NOT TRY HARD AND ARE NOT EXPORT-MINDED, COOPER TOLD

MATSUKAWA THAT US FIRMS HAVE PARTICULAR PROBLEMS EXPORTING TO JAPAN. THE TRADE FACILITATION COMMITTEE AND THE TRADE STUDY GROUP HAD BEEN ESTABLISHED TO DEAL WITH PROBLEMS OF MARKET ENTRY. UNFORTUNATELY, THERE HAVE BEEN FEW SUCCESS STORIES. COOPER ASKED THAT MATSUKAWA AND THE MINISTRY OF FINANCE SUPPORT MITI IN GETTING MORE SUCCESS STORIES FROM THE TFC. MATSUKAWA AGREED TO DO SO.

13. COOPER ASKED IF CABINET MINISTERS HAD ANY SPECIFIC IDEAS OR ONLY GENERAL UNEASINESS OVER THE YEN APPRECIATION. MATSUKAWA REPLIED THAT THERE WAS JUST GENERAL IRRITATION, BUT NO SPECIFIC IDEAS. MATSUKAWA AGREED TO CONVEY THEIR FEELINGS. HE HIMSELF DID NOT LIKE TO PUSH TOO FAR ON INTERVENTION, SINCE HE KNEW THERE WERE LIMITS. HE HAD RAISED A FEW SPECIFICS WITH THE MINISTERS, BUT THEY ONLY WANTED HIM TO ASK THE USG TO EMPHASIZE THE INTERNATIONAL ASPECTS OF POLICY ANNOUNCEMENTS.

14. COOPER SAID THE USG HAD LOOKED AT EXCHANGE MARKET INTERVENTION, BUT, LIKE THE GOJ, CONCLUDED THAT IT WAS NOT PROMISING. MATSUKAWA AGREED, POINTING OUT THAT AS MUCH AS \$300 MILLION A DAY OF "SPECULATIVE MONEY" HAD ENTERED JAPAN DESPITE GOJ CONTROLS ON INFLOWS. MOST CAME INTO "FREE YEN DEPOSITS" DESPITE FACT THAT THESE ARE NON-INTEREST BEARING ACCOUNTS WITH 100 PERCENT RESERVE REQUIREMENT. AT ONE TIME THE FORWARD-SPOT DIFFERENTIAL WAS AS MUCH AS 8 PERCENT, NOW IT IS AROUND 5 PERCENT.

15. ENGAGING MATSUKAWA IN A TECHNICAL DISCUSSION, COOPER ASKED IF THE BANK OF JAPAN HAD INTERVENED IN FORWARD MARKETS. (HE EMPHASIZED THAT HE WAS NOT SUGGESTING THE GOJ DO THIS). HE NOTED THAT SOME TECHNICAL LITERATURE SUGGESTS CONFIDENTIAL

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IT IS A MORE EFFECTIVE METHOD OF INTERVENTION AND HAS NO EFFECT ON THE MONEY SUPPLY (NOTE: THE EXPANSION OF M3 CAUSED BY BANK OF JAPAN INTERVENTION LED TO GOJ FEARS OF INFLATION AND CONTRIBUTED TO GOJ DECISION TO STOP INTERVENING DURING WEEK OF MAR 27). COOPER SAID THE IMF STAFF PAPERS HAD A SURVEY ARTICLE A FEW YEARS AGO. HE AGAIN SAID THAT HE WAS NOT RECOMMENDING THIS POLICY. HE ADDED THAT THE BANK OF ENGLAND HAD USED IT EFFECTIVELY, EXCEPT FOR ONE TIME IN THE LATE 1960S, WHEN IT GOT BADLY BURNED. MATSUKAWA SAID THE CASE WHERE THE BANK OF ENGLAND LOST MONEY WAS WELL-KNOWN IN THE BANK OF JAPAN.

16. MATSUKAWA RETURNED TO US POLICY ANNOUNCEMENTS. HE BELIEVED THIS WOULD REDUCE PRESSURE FROM LEADS AND LAGS WHICH WOULD SLOW SPECULATION. HE NOTED, HOWEVER, THAT SOME ASIAN COUNTRIES WERE BEGINNING TO SHIFT SOME OF THEIR RESERVES INTO YEN, WHICH WAS TROUBLESOME.

17. COOPER RECOGNIZED THAT WE MUST SEPARATE LONG TERM AND

SHORT TERM EFFORTS. OFTEN PROPER LONG TERM POLICIES WILL CREATE A GOOD PSYCHOLOGICAL IMPACT IN THE SHORT TERM. ONE AREA WHERE JAPAN COULD HAVE A MAJOR IMPACT WOULD BE TO IMPROVE SUBSTANTIALLY ITS MTN OFFER. IT WAS NOT EQUAL TO OURS AND WAS NOT AS GENEROUS AS IT COULD BE. COOPER SAID WE SOUGHT A COMPARABLE LEVEL OF AVERAGE BOUND TARIFFS AT THE END OF THE MTN. MATSUKAWA SAID IT WOULD BE HARD FOR THE MINISTRY OF FINANCE CUSTOMS BUREAU TO PERSUADE BUSINESSMEN TO ACCEPT A MORE GENEROUS TARIFF OFFER. IT WAS HARD TO CHANGE THE PRESENT OFFER, WHICH HAD BEEN HARD TO NEGOTIATE WITH JAPANESE FIRMS. COOPER REPLIED THAT IF JAPANESE OFFER CONTINUED TO BE UNSATISFACTORY, CONGRESS AND THE EC MIGHT WANT TO WITHDRAW WHAT HAS BEEN OFFERED.

18. ON THE BASE RATE/BASE DATE ISSUE, COOPER ONLY POINTED
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OUT THAT THE GERMANS HAD CUT THEIR TARIFFS IN HALF IN 1957 SO AS TO "CATCH UP" WITH OTHER INDUSTRIALIZED COUNTRIES WHICH WERE AHEAD IN TARIFF-CUTTING. THIS CUT WAS DOUBLY VALUABLE TO NON-EUROPEAN EXPORTERS BECAUSE THE LOWER GERMAN TARIFFS WERE THEN FACTORED INTO THE COMMON MARKET COMMON EXTERNAL TARIFF. BUT THE GERMANS DID NOT ASK FOR CREDIT IN THE "DILLON ROUND" OR IN THE "KENNEDY ROUND". THEY VIEWED THEIR TARIFF CUTS AS "CATCHING UP", OR ACHIEVING PARITY OF AVERAGE BOUND TARIFF LEVELS. JAPAN SHOULD CONSIDER ITS 1972 TARIFF CUTS IN THE SAME WAY NOT ASK FOR CREDIT, AND SHOULD SEEK TO ACHIEVE PARITY. MATSUKAWA SAID HE WOULD DISCUSS THE IDEA IN TOKYO.

19. COOPER SAID SOME THOUGHT MIGHT BE GIVEN TO TEMPORARY MEASURES, E.G., EMERGENCY IMPORTS SUCH AS COPPER. HE POINTED OUT THAT LOW PRICES HAD PUT ZAMBIA, ZAIRE AND PERU IN EXTREME DIFFICULTY AND NOTED THAT JAPANESE PANIC BUYING IN 1973 MAY HAVE RESULTED IN EXCESS PRODUCTION AND STOCKS NOW. MATSUKAWA SAID COPPER WAS AMONG EMERGENCY IMPORTS BEING CONSIDERED, AS WELL AS RARE METALS.

20. IN RESPONSE TO MR. HORMATS' QUESTION ON AID, MATSUKAWA SAID THAT GOJ WAS UNTYING AID AND CONSIDERING GIVING PART OF ITS AID ON CONDITION THAT IT NOT REPEAT NOT BE SPENT IN JAPAN. MR. COOPER SAID THIS WAS A GOOD IDEA AND POINTED OUT THAT DURING THE EARLY YEARS OF THE MARSHALL PLAN, US AID WORKED THIS WAY, E.G., MARSHALL PLAN AID TO FRANCE WOULD HAVE TO BE USED TO BUY GOODS IN, FOR EXAMPLE, GERMANY. THIS GAVE OUR AID A MORE SUBSTANTIAL IMPACT ON EUROPEAN RECOVERY.

21. FINALLY, MR. COOPER ASSURED MR. MATSUKAWA THAT THE US GOVERNMENT WAS NOT OBLIVIOUS TO JAPAN'S DIFFICULTIES. THE US EMBASSY IN TOKYO HAS "BOMBARDED" US WITH INFORMATION ON DEVELOPMENTS IN JAPAN AND ON THE THINKING OF THE CABINET AND VARIOUS MINISTRIES. WE HAVE BEEN WELL-INFORMED ON JAPAN'S RECENT UNEASINESS. COOPER EMPHASIZED THAT IT WAS

GOOD TO HAVE DIRECT AND FRIENDLY CONTACT WITH MATSUKAWA IN
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WASHINGTON. MATSUKAWA SAID THAT JAPAN FELT LIKE IT HAD BEEN
"PUSHED OUTSIDE THE MOSQUITO NET" (KAYAGAI DE NOKOSARETA).
COOPER REASSURED HIM THE ECONOMIC POLICY GROUP (BLUMENTHAL,
SCHULTZE, COOPER, MCINTYRE, ETC) HAS DISCUSSED JAPAN REGU-
LARLY. THE USG WOULD LIKE TO FIND A WAY TO EASE SOME OF
THE PRESSURE, BUT DOES NOT WANT TO DO ANYTHING FOOLISH OR
HARMFUL.

27. IN ADDITION TO MR. COOPER, ROBERT HORMATS (EB), ERLAND
HEGINBOTHAM (EA), JOHN WILSON (E), AND HERBERT COCHRAN (EA/
J) WERE PRESENT. ON THE JAPANESE SIDE, MR. MATSUKAWA WAS
ACCOMPANIED BY EMBASSY FINANCIAL MINISTER MATSUMURO, FINAN-
CIAL COUNSELOR OZAKI, AND MR. KANEKO (ASST TO MR. MATSUKAWA .

23. MATSUKAWA ALSO MET CEA CHAIRMAN SCHULTZE, AND TREASURY
SECRETARY SOLOMON. AFTER SPENDING APR 6 IN NEW YORK, HE
MET WITH TREASURY UNDERSECRETARY SOLOMON, MR. WITTEVEEN
(IMF), AND FED CHAIRMAN MILLER ON APRIL 7. CHRISTOPHER

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